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KHPA Staff Recommendations: Provider Taxes in Kansas

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This summary provides some background on provider taxes in Kansas and offers a recommended approach to the consideration of any new taxes on health providers in the state. Three options are presented in consideration of a new tax on nursing homes in the state. These options focus the Board's review on compliance with Federal requirements, transparency in the design of a tax program, and consistency in the design of a tax program to support state health policy goals.

What are provider taxes?

A provider tax is a mechanism to maximize the amount of federal funding for a state by generating new in-state funds and matching them with federal funds in the form of increased Medicaid payments to providers. The end result is that the state receives additional Medicaid dollars.

State Medicaid programs across the country levy such taxes and fees in this way. The state of Kansas currently levies an assessment on hospital revenues of 1.83%. The proceeds are matched with Federal funds to provide enhanced reimbursement rates to hospitals, who receive 80% of the revenue, and physicians, who receive 20% of the proceeds. Funding is overseen by an appointed panel consisting of hospitals, physicians, the state's health care safety net association, and the two Medicaid MCOs. The annual report prepared by this panel indicates that the assessment generated about $98 million in revenue over the past three years, resulting in increased hospital and physician rates totaling about $236 million, including Federal matching funds of about $149 million.

How do provider taxes work?

Tax revenue is collected from a specific type of health care provider, e.g., hospitals. This money is used as the state share for making Medicaid payments to that class and other classes of health providers, e.g., hospitals and physicians. The state share of the total amount of tax is matched by the Federal government at the rate of approximately 60%, multiplying total revenue available for additional health care payments. Proceeds are used to enhance payments to Medicaid providers, often including both those classes of providers that were included in the tax and other classes of Medicaid providers as well.

Federal law requires that the taxes be minimally redistributive, so that all taxpayers are not "held harmless" for the tax. However, providers *as a group* often find the net impact of these tax programs to be attractive, contributing to their widespread use across the country. Designing a program that meets Federal guidelines and generates

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sufficient support among stakeholders is a technical, time-consuming process. Many health care tax programs are designed by provider associations. For example, the current hospital assessment in Kansas was designed by consultants under contract with the Kansas Hospital Association. Nursing home proposals presented to the legislature in recent years were developed with funding from Kansas' for-profit nursing home association. The design costs of a provider tax are a constraint for states: total costs can reach into the hundreds of thousands of dollars.

Simple example of a provider tax program:

- *Initial tax on health care services*. The first step in the process is to adopt a tax on health care services. Consider a tax that raised $10M in taxes to the state.

- *Increased Medicaid payments*. The second step is to use the increased revenue to increase Medicaid reimbursements, generating additional Federal matching payments at the rate of 1.5 to 1 (a 60% match rate). With Federal matching payments, $25M is available for distribution:
    - State share=$10M=40% of $25M
    - Federal share=$15M=60% of $25M

- *Net impact on providers and the state.* The $25 million in new Medicaid reimbursements is typically split between providers who contributed to the tax and other kinds of providers who were not taxed.
    - *Taxpaying providers.* Most taxpaying providers end up net winners due to the increase in Medicaid reimbursement. The Federal government requires that the tax result in some redistribution of funds on net, so that some providers will inevitably lose.
    - *Non-taxpaying providers*. Non-taxpaying providers who benefit from the increase in Medicaid reimbursements are pure winners. Kansas physicians receiving enhanced Medicaid payments financed with the state tax assessment on hospitals are unambiguous better off and more likely to see Medicaid patients – a core policy objective in the program.
    - *State spending*. The net impact on state expenditures is typically designed to be zero, with all proceeds from the tax used to finance increases in Medicaid payments, but over time a net cost to the state usually emerges as the cost of the Medicaid reimbursement increase grows.
        - For example, an increase in the rate of reimbursement for hospitals and physicians may grow with normal increases in caseload, while revenue from the hospital tax does not necessarily grow over time.
        - Despite any additional state spending in future years, the rate of return for the state as a whole is significant and greatly exceeds the normal return available through Federal matching funds.
        - It is simple to design a tax that creates new, unencumbered revenue for the state if some funds are withheld from Medicaid and not used to draw down additional Federal matching funds, but this increases the number of providers who are net losers and makes it very difficult to sustain political support for the tax.

Provider tax options in Kansas

At the start of the 2008 Medicaid Transformation process, the KHPA Board asked staff to develop options and recommendations for provider taxes in the state, and to bring those options back to the Board for consideration prior to the start of the 2009 Legislative Session. KHPA staff worked with the Kansas Department on Aging, the Kansas Insurance Department, and a health care consulting firm under contract to the KHPA (Health Management Associates) to identify classes of health care providers that could be considered for development of a specific provider tax in Kansas.

This review identified four potential taxable classes of providers in Kansas:

- *Hospitals*. Kansas currently has a provider tax in place for hospitals that appears to take full advantage of Medicaid payments in this area. A special committee, the Health Care Access Improvement Panel, is established by Kansas statute with the review and oversight of this program. The Panel met most recently in October 2008. Neither additional taxes nor adjustments to the payment formula are recommended at this time.
- *Nursing homes*. The Kansas legislature has entertained a number of proposals for a nursing home assessment in recent years. The large number of Medicaid beneficiaries in many nursing homes makes this the most promising untaxed class of providers. At least 30 other states have a nursing home tax in place. The Board has been presented with detailed reviews of nursing home tax options in Kansas.
- *Intermediate care facilities for the mentally retarded (ICFs/MR).* While the high percentage of Medicaid residents in ICFs/MR make a tax on this class attractive in some states, the small number of facilities in Kansas, coupled with Federal limits on potential increases in Medicaid reimbursement, limit the net gain from such a tax. The benefits to the state do not appear to be large enough to justify further development of this option.
- *Managed care organizations (MCOs).* Current state law authorizes a tax on MCOs, but new Federal rules make it much more difficult to construct a viable tax program. Several large states are abandoning taxes on MCOs. This option does not appear to be viable in Kansas.

KHPA's review of provider taxes in Kansas suggests that the only un-tapped possibilities rest in a potential tax on nursing homes. However, KHPA's analysis took into account only the financial impacts of a tax program, including the re-distributional impact on providers, the net increase in reimbursements, and the total size of a potential program. This analysis suggests that significant revenue could be generated from such a tax, and that many providers would benefit: both are a pre-requisite to political viability. However, there are other considerations with the imposition of a nursing home tax. Because of the impact on reimbursement rates, provider tax programs can have a significant and real impact on beneficiaries and providers that go beyond changes in the flow of funds. In addition, depending on the design, some provider tax programs may attract the attention of Federal auditors. Given KHPA's statutory charge to coordinate and advance sustainable and transparent health policies, the broader impact of a provider tax program should be considered.

Suggested principles for evaluating new provider taxes

KHPA staff recommend the following guidelines in the Board's consideration of specific proposals for a provider tax:

1. *Compliance. Financing proposals need to comply with statutes and other Federal rules governing the use of provider taxes.*

2. *Transparency. The short- and long-term impact of a provider tax program can be difficult to understand, and can change over time. Policymakers should have access to good information about the proposal's impact on:*

    a. *Providers of different types*

    b. *Medicaid beneficiaries*

c. *Other health care consumers*

d. *State finances in the short- and long-term*

3. *Consistency. Proposals should benefit the state by advancing established policy goals.*

    a. *Proposals may focus on increased access for populations in need, e.g., supporting expanded Medicaid coverage or access-enhancing rate increases.*

    b. *Proposals may focus on enhancing quality of care, e.g., enhanced rates to support specific improvements in services.*

    c. *Proposals should reflect any other established policy objectives. For long-term care, this would imply that, in addition to ensuring access to high quality services, a provider tax program would support the central goal of providing services in the least restrictive environment meeting each individual's needs.*

These guidelines suggest the need for careful evaluation of any provider tax program. This evaluation entails a review and application of Federal rules, a process that KHPA should take the lead on given its role as the "single state agency" responsible for the appropriate use of Federal matching funds in Kansas. Nevertheless, specific analysis of the impact of a tax on beneficiaries, providers, and the advancement of health policy goals may be the purview of the agency with direct responsibility for health policy related to the proposed class of taxed providers. The lead agencies for long-term care policy in Kansas are the Kansas Department on Aging (KDOA) and the Department of Social and Rehabilitation Services (SRS). Health policy related to long-term care for seniors is the purview of KDOA.

KHPA policy options:

KHPA staff have reviewed the options for the imposition of additional provider taxes in the state and have identified nursing homes as the most viable class of providers that could be taxed within Federal guidelines. Specific proposals have been developed by nursing home provider groups and introduced as legislation in previous sessions. Development of a proposal that could be advanced in the 2009 legislature could require significant new analyses, a significant hurdle given the state's fiscal crisis. Nevertheless, KHPA staff recommend an analysis of the impact of a provider tax on key health policy goals in the state before advancing a specific proposal to the legislature. These policy goals are the direct purview of the Department on Aging.

Options for Board action include:

1. Endorse the provider tax guidelines
2. Ask KDOA to identify a specific nursing home tax proposal, evaluate it according to the guidelines proposed above, and return to the Board with a recommended course of action on a nursing home tax
3. Ask KDOA to apply the guidelines in reviewing nursing home tax proposals and take appropriate action in forwarding any specific provider tax proposals